RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 17, 1987 **LETTER 967**

THE MARKET: There is no scarcity of forecasts and predictions here in June 1987. The market "experts" are out in full force, and they're offering their crystal ball views in newspapers, in magazines, on TV, and by direct mail. "Dow 2800 by August." "3000 on the Dow by the end of the year." "The market will be up another 25% by 1988." What are all these predictions worth? They're worth absolutely -- NOTHING.

There's only one prediction worth anything at this time or any other time, and that's *the prediction (or the verdict) of the marketplace.* And today that verdict boils down to one point on the Dow -- that point is Dow 2405.54. What's the significance of 2405.54? That's the level the Dow hit on April 6 when it recorded its last bull market high.

The fact is that the D-J Averages have been in technical "no-man's land" ever since early April 6. On the downside of no-man's land the D-J Transports have been the tigers, refusing to break below their April 28 low of 908.03. A breaking of that level by the Transports would signal a primary bear market. So far, the Transports have steadfastly refused to render that fateful signal.

So it's simple, isn't it? If the market won't go down, it will surely go up. And the market has pushed higher, led by the powerful Transportation Average, which rallied above the 1000 level for the first time in stock market history. But in this business "it takes two to tango," and that's another way of saying that *a move by one Average, unconfirmed by the other, is meaningless for predictive purposes and very apt to be deceptive.*

Yes, all we need is that final advance by the Dow above the April 6 high of 2405.54. So far, the much-desired "new Dow high" has not been forthcoming. Maybe tomorrow, maybe next week, maybe next month, but as this Letter is written the Dow has kept Wall Street fretting, wondering, and scratching its collective head.

What, if anything, could be wrong? Well, for one thing the Transportation Average is selling at an astronomical price. Today the D-J Transports are selling at an unbelievable 40 times earnings to yield a minuscule 1.55%, the lowest yield in history. At the same time the Dow is selling at 18.4 times earnings to yield a dangerously low 2.89%. This puts the Dow in the "below 3% yield" area, a yield level which has accompanied every market top in this century.

"But," say the optimists, "we've got a new situation today. This is a global market with mountains of money on the world's sidelines, money which is just begging to buy up US corporations." Maybe so, but in my mind the situation really doesn't warrant any guessing or new-era theorizing. The Industrial Average either will reconfirm the bull market by bettering 2405.54 -- or it won't. The Transports either will hold above 908.03 -- or they won't. Why guess? Why should you or I try to play Wall Street genius? Ultimately, the market will give us the answer as it always does. So why don't we practice a little patience and wait the verdict of the marketplace?

There are a few facts that might bear repeating here. For one, the current advance, 1984 to date, is now the greatest and the longest uncorrected advance in stock market history. Since July 1984 the Dow has risen 121% without so much as a 10% correction. By the same token, since July 1984 the Dow has advanced for 35 months without so much as a 10% correction. These are statistics that have never been seen before in the 92-year history of the Averages.

June 5 DJIA 2326.15; PTI 2571: A-D Ratio -6.32
June 12 DJIA 2377.73; PTI 2606; A-D Ratio -5.50

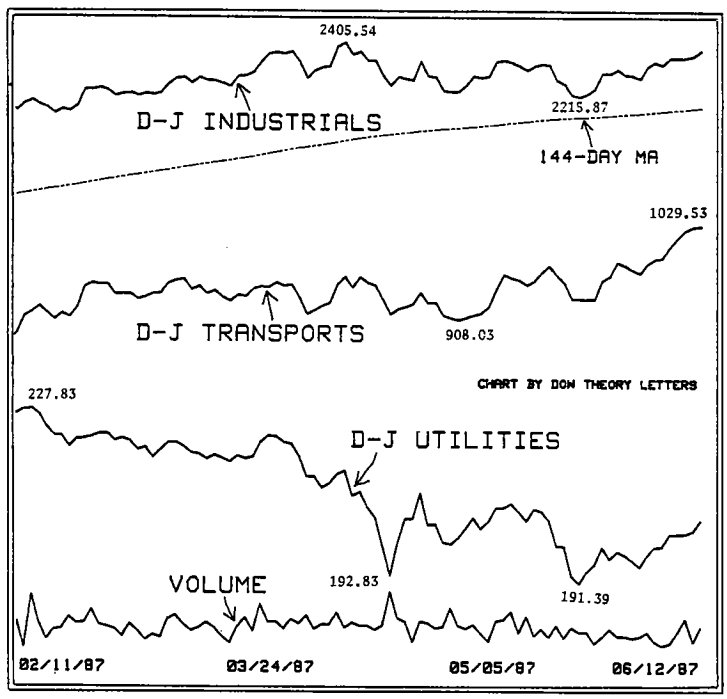
I love records, I really do, but when the Dow rises 35 months on end, up 121%, without a correction -- and the yield on the Dow drops to 2.89% in the course of that rise, well my feeling is that a certain amount of caution is warranted.

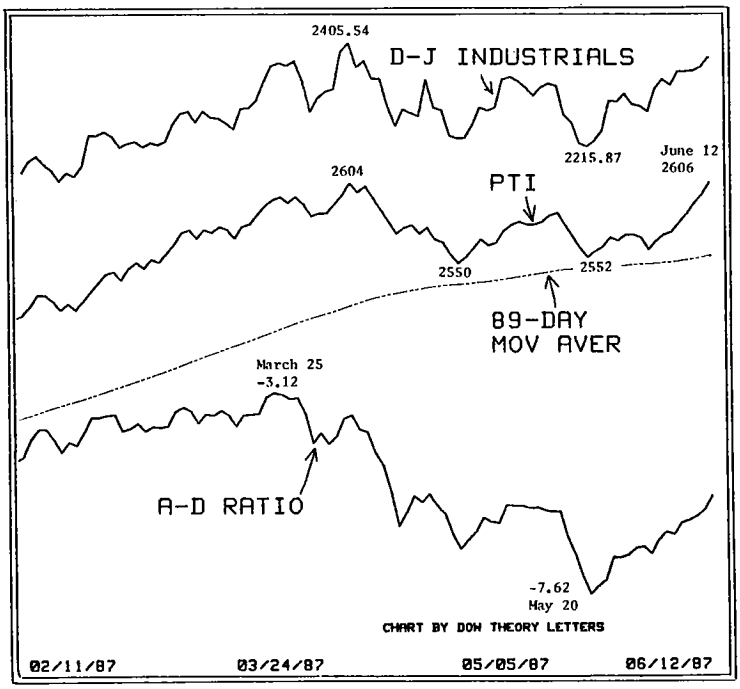
Now remember, I'm not pussyfooting around with little raised-finger warnings and "oopses" and "be carefuls." I'm trying (by every way I know) to figure out whether the primary trend of the stock market is still bullish -- or whether a bear market may have started on April 6 (that's the day when the D-J Industrials and Transports recorded their last confirmed highs). This is the biggest and most important question on Wall Street (or any other street) today. This is the $64-billion question. The answer to this question will have repercussions far beyond the simple matter of whether your stocks or mine are going up or down.

DATES & HIGHS: Despite what you may think or hear, there's a logic to the action of the market. Unfortunately, that logic is usually uncovered long after the event. Mapping out the chronology of events helps to unravel that market logic, and toward that effort I submit the following dates and statistics.

The D-J Utility Average hit its bull market high way back on January 22 at 227.83. Currently, the Utilities have a long way to go to reach new highs (see page 1 chart). I might add that the Utility Average will often "make its move" many months ahead of the rest of the market, and for that reason the Utility Average is frequently referred to as "the bellwether Average."

The advance-decline ratio topped out on March 25 at minus 3.12, and the A-D is currently about three points below that high (see page 2 chart).





My Primary Trend Index hit a high of 2604 on April 6, and as this is written the PTI is 13 points below its high (however, the PTI is still climbing optimistically above its 89-day moving average).

The D-J Industrial Average hit a bull market high of 2405.54 on April 6, and although the Dow is approaching that high it has not yet bettered it. *It will take a Dow closing above 2405.54 to reconfirm this bull market. The reconfirmation does not have to come today or tomorrow, but it must come.*

Meanwhile, the surging D-J Transports have pushed above 1,000 for the first time in NYSE history. But again it is crucial to remember that the new Transport high doesn't mean a thing from a Dow Theory standpoint unless the Dow confirms.

ECONOMICS AND THE STOCK MARKET: A lot of very intelligent economists are now saying that a world slowdown is at hand. The seven big industrial nations met in Venice last week, and the fact is that their respective economies are practically at a standstill. In fact, not one of the seven nations at the Venice meeting expects growth of more than 3% this year.

Does that mean that we are heading into a global bear market in stocks? It does not. The market, as older subscribers know only too well, does not trade on news that is known. Nor does the market have to dovetail exactly with the US economy or any other economy. The market moves on the expectations of investors, and it moves on the buying and selling of big money, "informed money."

There have been times when the stock market has discounted coming events, as much as a year and half or two years away. And there have been other times when the market has moved literally on top of events. Therefore, the most difficult task in the world is to attempt to analyze (or forecast) coming events and from that "knowledge" predict the trend of the stock market. It can't be done. It can't be done first because no one can predict the future. And secondly, even if you could predict the future you would not know how the market was going to react to the actual events.

NEWS AND THE STOCK MARKET: So much for economics as an aid to making money on Wall Street. Now let's talk about stocks and news. People seem to believe that some news event like the departure of Fed Chairman Volcker or the blowing up of a US naval vessel will "set off" a bear market. Forget it, bear markets just don't start that way.

As I've written dozens of times before, news will not reverse the primary trend. News such as the Volcker departure may produce a one-day or a one-week drop, but it will not change the direction of the primary trend. A primary bull or bear market ends in only one way -- in exhaustion. I define exhaustion in a bull market as the point at which the market runs out of informed buyers or the point at which the last bull has spent his money. Conversely, exhaustion in a bear market arrives at the point at which the market has run out of informed sellers or the point at which the last bear has sold his wares.

We start looking for hints of the end of a bull market *when that bull market enters its third and final phase.*. The characteristics of the third phase are low yields (i.e, very few investment values), high volume (signifying active public participation), an abundance of tips and rumors (signifying distribution), and a general atmosphere of good feeling or even euphoria (which provides a perfect background for distribution). Obviously, not all these indications will be present at every bull market top and obviously not everyone will agree as to whether they are all there. At or near a bull market top it's always a question of "How hot is hot?" You'll get a dozen different answers from a dozen different people. *In my opinion, the great bull market which started at Dow 577.60 in 1974 is now definitely in its third phase.*

INVESTMENT POSITION: Old Taurus, the one-horned bull continues to own the box. The bear has tried for two months to kill this bull. The bull has weakened, but he's still very much on his feet. The bear has backed into the corner, and he's licking his gore-wounds. He'll return later when he's stronger.

Our policy is to continue taking some profits. The Dow may go higher, even a lot higher, but history says that taking profits when the Dow yield is well below 3% (as it is now) has been good policy.

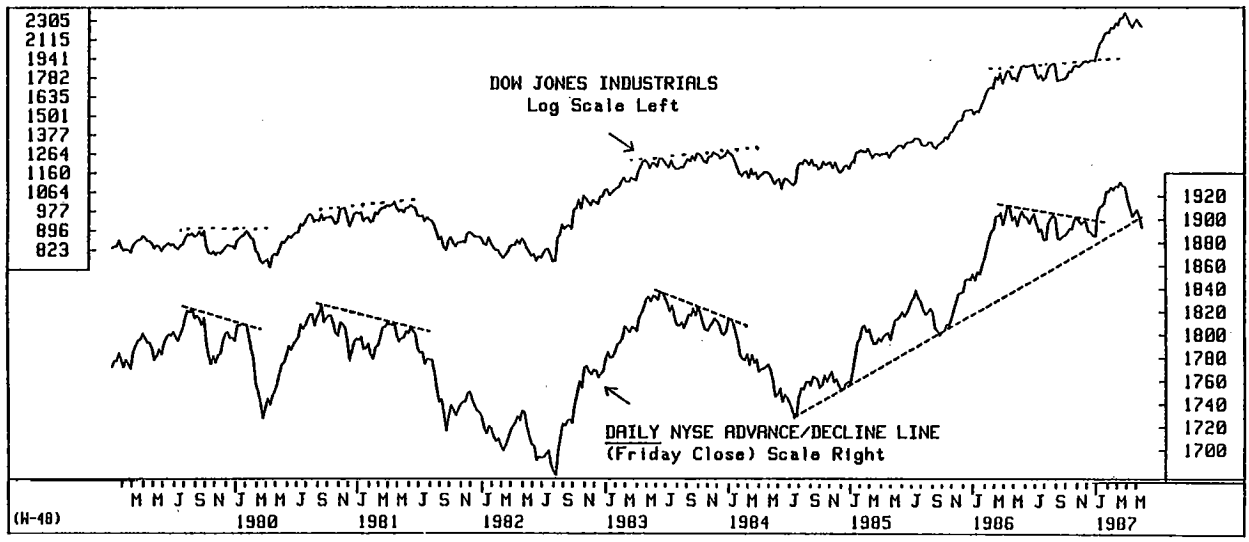
Bonds are building an impressive base here, and I don't see anything wrong with going out say five years in AA- or AAA-rated bonds. Meanwhile, muni cash funds (state and federal tax-free) yield around 4%, which is worth roughly 7% to high income investors. That's hard to beat, considering their extremely high degree of safety.

BREADTH: Subscribers have asked, "Russell, if you had only a few market items to monitor, which ones would you choose?" My immediate answer is always, "Give me the D-J Averages, volume, and the daily advances and declines. Everything else is just icing on the market cake." I talk about the Averages and Dow Theory endlessly in these reports, but I haven't talked about the advance–declines for quite a while. So here goes.

The advance-decline study is an interesting story in itself. I started writing about the implications of the daily NYSE advances and declines in the early 1960s Obviously, I wasn't the first in the field. The pioneering work on the advance-declines was done back in the 1920s by Colonel Leonard Ayres of the Cleveland Trust Co. Ayres believed that major turning points in the market were preceded by changes in the banking trends. To his frustration, however, Ayres realized that there was no dependable method of timing intervals between changes in the banking trends and subsequent reversals in the stock market.

So the Colonel decided to look within the market itself for indications of the turns. Starting in January 1926 Ayres began counting the number of issues that advanced or declined each day on the NYSE. This research resulted in the Ayres Breadth Index or as it is now called, the advance-decline ratio.

One of the first items Ayres noticed was that it was the differential between daily advances and declines that was important. The second item Ayres noticed was that the differential needed to be adjusted, since the number of stocks traded on the NYSE was increasing year by year. To adjust the differentials, the Colonel



simply divided the daily differential by the number of stocks traded each day. This produced the advance–decline RATIO, an index that is properly adjusted each day for the number of issues traded on the NYSE.

In studying the statistics, Ayres discovered that the *failure of his breadth index to stay in gear with the D-J Industrial Average foreshadowed many important turns in the market.* The Colonel's observations proved of great importance when it was later seen that divergences between the Dow and the A-D ratio foreshadowed the major bull market peaks of both 1929 and 1937.

One of the Colonel's most ardent students was a broker at the old stock exchange firm of Auchincloss, Parker and Redpath, James Hughes. During the 1950s and '60s Hughes wrote a weekly market comment for his clients at Auchincloss, Parker, and I still have my tattered copies of this highly informative publication. Hughes' comments dealt almost entirely with the A-D ratio, the Dow, the banking statistics and how these three pertained to the trend of the market. Hughes' success in calling the trend was almost legendary, and he developed a small but dedicated following among market students of the 1960s.

I talked to Jimmy Hughes many times during the 1950s and '60s, and I remember asking him about his insistence that only the daily A-D ratio figures are significant. His answer was that it is only through the daily figures that we can identify the all–important divergences (i.e., divergences between the A-D and the Dow). For this reason, Hughes declared the weekly A-D figures useless (although the weekly statistics are accorded a good deal of credence by many of today's market analysts).

How did Hughes do it? Why was he successful and why were his market calls so accurate? The basis of Hughes' market analysis was the "breadth selling climax," which he used for identifying market bottoms and the "price/breadth divergence," which he used for identifying market tops.

Hughes based his breadth (downside) climaxes on days which produced extremes in declines over advances. I found the climax approach to calling bottoms useful but at times frustrating since one never knew how many selling climaxes might appear before a final bottom was established (often during a bear market a selling climax will simply produce a good rally and then prices would dive to new lows again).

I now use a number of different indicators for identifying bottoms. Nevertheless, most of these newer techniques are still based on the action of daily advances and declines, with in some cases the addition of daily volume.

I continue to find the action of the A-D ratio in relation to the Dow of utmost importance in identifying tops. As a rule, a series of two or more highs in the Dow accompanied by two lower peaks in the A-D ratio is cause for concern. Many important secondary reactions and more than a few primary bear markets have started with this kind of divergence.

The duration of the price/breadth divergence can also be significant. The rule that Hughes used was that any series of divergences lasting six months or more is probably of primary significance. In other words, if you see a series of new highs in the Dow accompanied by a series of declining tops in the A-D ratio with the entire series lasting six months or longer -- watch out. Such extended periods of divergence almost always lead to trouble and often BIG trouble.

Let me give you a recent and most memorable example. In April of 1971 the daily A-D ratio hit a peak along with the Dow (the Dow peak was 945). A decline carried into November, whereupon the Dow advanced through 1972 to a new high of 1038. But all during 1972 the A-D ratio (along with the majority of stocks) drifted lower. Very few market analysts seemed particularly disturbed by this action (although I wrote about it almost obsessively).

But the trouble finally appeared -- with a vengeance. In early '73 the Dow turned down along with the A-D ratio, and a vicious bear market decline carried the market lower right to the end of the year. The following year was no better. The bear held the market in its grip all during 1974, and by mid-1974 it was apparent that we were living through the most disastrous bear market since the 1930s. A final severe washout occurred during October to December of 1974. In early December the Dow bottomed out at 577.60, but the A-D continued down for another two weeks.

That two weeks of price/breadth divergence in late-December was of great help in identifying the final bottom. The bear market ended in December 1974, and early 1975 found the market rising explosively. During that entire 1973-75 period (as my older readers know), the tell-tale action of the A-D ratio proved to be invaluable.

All of which brings us to the present. Turn to the chart on page 2. Note that during the March-May decline the A-D ratio dropped from a peak of minus 3.12 to a May 20 low of minus 7.62. This drop represented a loss of 4.50 points or 86% of all the gains seen during the 1987 advance. A wipe-out such as this indicates poor action on the part of the A-D ratio -- and not simply because it indicates a declining tendency on the part of a large number of NYSE stocks. No, the reason why the severe March-May drop in the A-D ratio is important is because it sets up a TECHNICAL PROBLEM.

The problem is this: by May 20 the A-D ratio had fallen so far that it was doubtful whether any forthcoming rally in the Averages (more specifically in the Dow) would be able to take the A-D ratio to new bull market highs again. In other words, the big March-May drop

in the A-D ratio put the Dow and the A-D seriously "out of sync." When this kind of action has occurred in the past, the result has been either (1) a break to new lows by both the Dow and the A-D ratio; in other words, a downside washout which serves to get both the Dow and the A-D ratio back in gear again. Or (2) a series of new highs by the Dow unconfirmed by the lagging A-D ratio. This extension of the divergence results in an even larger top which may require many months to form (as in 1971-73). The ultimate result of such an extended, diverging top can be a nasty correction or more often a primary bear market.

Conclusion: In breaking so badly during the March to May period, the A-D ratio has indicated that this market is in technical jeopardy. This is another way of saying that the odds for new highs in both price (i.e, the Dow) and breadth (i.e., the A-D ratio) are not good. If, in fact, the A-D has seen its highs, then the market is going to have a very difficult time in the period ahead. Of course, it is conceivable that both the Dow and the A-D will climb to new bull market highs (remember, "the market can do anything") -- but in my mind, such a happy outcome is doubtful.

LONG-TERM PRICE-BREADTH STUDY: I am including a chart (page 3) which covers a much longer period of time, the period between mid-1970 and the present (chart courtesy of Ned Davis Research, Inc). Here we see three previous examples of extended divergence between price and breadth. The outcome of each price/breadth divergence was an important decline. These declines occurred during 1980, 1981-82, and 1983-84.

The latest period of protracted price/breadth divergence occurred during 1986. But during early-1987 a most curious phenomenon occurred. The Dow and the A-D ratio suddenly turned up in early-1987, and within a matter of a few months both the Dow and the A-D roared to new bull market highs. I term the 1987 action "curious" because *it is highly unusual for any price/breadth divergence to resolve itself on the upside.* Nevertheless, there's no arguing with the stock market --- that's what happened!

Then a second curious phenomenon took place. On March 25 the A-D ratio turned down again, and a few weeks ago, as you can see on the chart, the A-D ratio broke below its rising trendline, a bullish trendline which has held in force for almost three years.

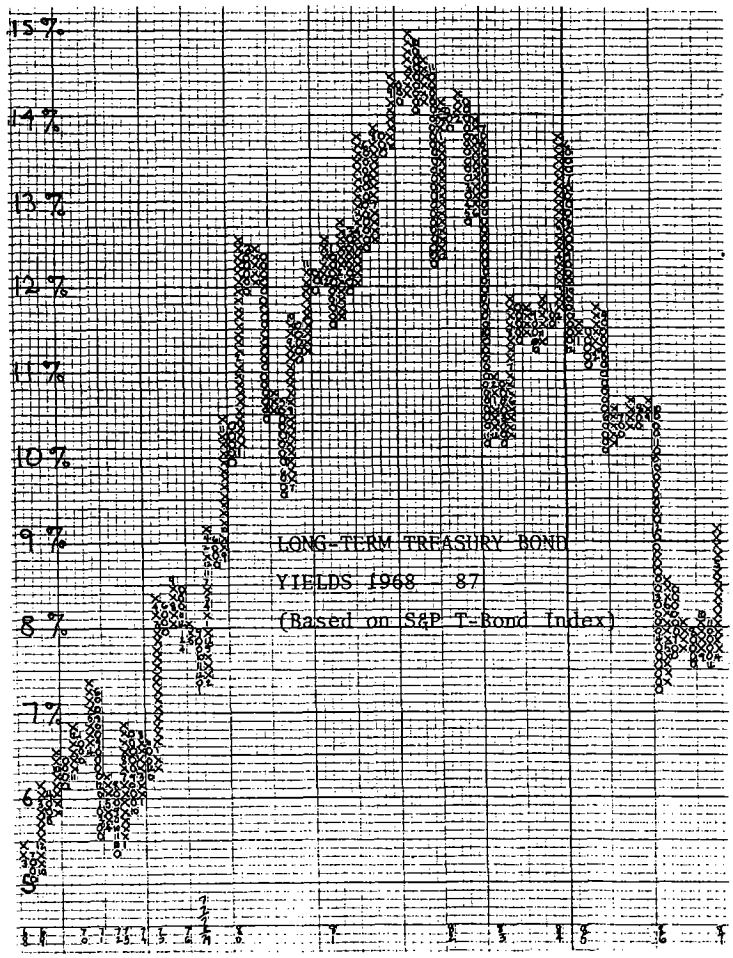
What do I conclude from this study? My conclusion is the same as in the previous study. It appears that the A-D ratio is in trouble. The A-D ratio has wiped out most of its 1987 gains and in the process it has broken below its three-year bullish trendline. With the Dow still trying to climb and with the A-D ratio clearly weak, we could get a "stand-off" type of sideways market for a while (even while the Dow remained strong). But in the end I think the weak A-D will rule the market. And that is not a bullish conclusion.

NOTE: For those serious students who would like to go into the price/breadth studies more thoroughly, I offer daily charts of the Dow and the A-D ratio going back to 1931 (a large 11" x 17" page for each single year). The charts are three-hole punched and enclosed in a large three-ring binder. These chart books are unique and deserve many hours of study.

I also offer a companion chart book of the D-J Averages going all the way back to 1896. Each page contains the daily action of the D-J Industrials, Transports, Utilities, and Bonds along with daily volume and comments on the news of the year. These chart books have been purchased by investors and institutions the world over and constitute an invaluable source of information for serious market students. I update both albums with new pages each January.

Price for the A-D album is $95 and for the D-J Averages $135. Please make checks out to Richard Russell. We pay the postage.

INTEREST RATES: One problem with most market studies is that they place too much emphasis on the shorter term. I like perspective, and that means that I need long-term charts. Here's a P & F chart of the S & P long-term government bond yields going back to 1968. I think this chart is worth careful study -- particularly now that fluctuations in interest rates have become so critical -- both to the markets and to the economy.



Starting from a base in the 5% to 7% area, T-bond yields broke out in 1975 and headed higher. By 1980 the rates had risen to 12.6%. They then backed off to 9.6%, but during 1981 (amid rampant inflation) rates exploded to 14.9%. That proved to be the peak for interest rates.

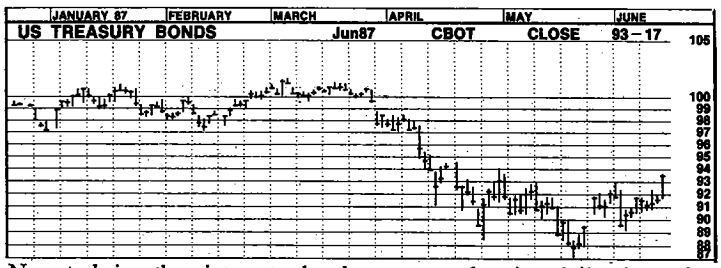
Along with all inflation-oriented items, the T-bond rates headed down. By 1982 rates had fallen to 10.2%. A spike took them back to 13.8% in 1984, and from that point it was down all the way.

In April '85 the T-bond rates collapsed to a low of 7.3%. Rates consolidated during the rest of 1986, holding in the 7.5% to 8.5% range. That takes the picture to 1987.

This year rates broke out of the consolidation pattern, pushing to a May-June high of 9.2%. But what happens from here? My own guess, and this is merely a guess, is that the downside of this pattern has not been completed.

I feel that there is a good chance that rates on the T-bonds could fall back into the 5% to 7.5% base which was formed during the period from 1968 to 1974. Such a move would give this chart a "completed look," a look that I have seen so many times on long-term P & F charts.

What, you ask, could possibly bring T-bond rates back to the 5-7% area? The only thing I can come up with is that maybe we face a long, drawn-out period of economic contraction (probably a global economic contraction). A bear market in the stock market and the economy with its accompanying deflation would *undoubtedly bring about a global effort to re-stimulate the various economies via lower rates.* If so, this chart could assume a symmetrical look as yields sank back into the 5% to 7.5% zone last seen during the 1968-74 period.



Now to bring the picture to the shorter term, here's a daily chart of the near-term T-bond contract. As I see it the bonds are forming a head-and-shoulders bottom. If the bonds can get above 94, such action would represent a clear breakout. In that event, I would expect the bonds to advance to the 96-97 area. Of course, this would mean lower interest rates -- exactly the opposite of general expectations at this time.

NOTES & QUOTES: Lyndon Johnson, Richard Nixon, Gerald Ford, Jimmy Carter: All were either weakened or knocked out of the box during their years of presidency. Now add Ronald Reagan to the list. For six years "the Teflon President" dominated Congress with his personality and ability to communicate. Then came the Iran-Contra catastrophe. And the Democrats in Congress seized on this as a golden chance to peel off the teflon. It worked.

Today, Reagan is a weakened president faced with a Democratically-controlled Congress that threatens to fight the president on every front. Congress wants to raise taxes, cut defense spending and institute new domestic spending programs -- all the while keeping Reagan against the wall with its interminable Iran-Contra hearings. The outcome — basically a rudderless America run by an administration that has its back to the wall.

* *

Salomon Bros. has come out with its best investments for the last 12 months. No. 1 was silver up 40%; 2 gold up 29%; 3 oil up 27%; 4 stocks up 21%; 5 US coins up 11%. The worst investment over the last 15 years was diamonds up a compounded 4.1% in 15 years. This year diamonds are up 7%, and the Russell opinion is that diamonds are now cheap. When buying a diamond, however, you MUST (1) love its look, (2) get a G.I.A. certificate, (3) know prices, (4) understand the four C's, carats, color, cut, clarity. The average buyer gets killed when buying a diamond. Why? Because he's an amateur buying an unknown item from a professional.

* *

Brazil is facing its worst recession ever. The country is facing a staggering foreign debt, collapsing car sales, 21% inflation, and a skyrocketing state deficit.

* *

Veteran subscribers know that I have been a fan of investor Warren Buffett of Omaha for many years. But I wasn't enough of a fan. I guess it was about 10 years ago that I bought a batch of Berkshire Hathaway stock for $250 a share. About five years later I sold it for $1250 a share because I thought it was overpriced (and because it never paid a dividend). Today the stock sells for around $3400 a share. Buffett is the only investor who ever made over $1 billion in the stock market. He not only did it honestly, he did it the old-fashioned way -- via fundamental analysis. Buffet and his wife own 45% of BKHT stock, and that 45% is now worth $1.7 billion.

Incidentally, a new book about Buffett has just been published -- "The Midas Touch" by John Train (Harper & Rowe, $17.95). The book provides an excellent glimpse into Buffet's life, ideas, and background as well as detailed discussions of Buffet's investment philosophy and techniques. A quote: "Privilege without responsibility is a formula for decadence. ... Buffett, who doesn't want to subject his children to such dangers, has created trusts for each worth a few hundred thousand dollars, but does not want to give them more for fear of corrupting them. He says: 'My kids are going to carve out their own place in this world, and they know I'm for them whatever they do.' But he refuses to bequeath them 'a lifetime supply of food stamps just because they came out of the right womb.' ..."

* *

One of the most important and far-reaching struggles in modern history is now taking place. This monumental struggle is occurring within Russia where reformer Gorbachev now finds himself caught in the middle -- caught between the old guard on the right (who are threatened by Gorbachev's advanced ideas) and the younger element on the left (who believe that Russia will be left in the economic dust if it proceeds along what it considers to be Gorbachev's overly- conservative course).

The June 4 NY Times contained an article on the Gorbachev dilemma, and I include a few paragraphs from that extremely important article below:

> One party theorist has reportedly circulated an analysis saying that without sweeping measures to introduce competition in the economy, the Soviet Union will fall behind the United States militarily in five to seven years.
>
> Moreover, many of the demands for further change have been published in the Communist party newspaper Pravda, which, even in this day of more freewheeling public debate, is still presumed to represent the views of top party leaders.
>
> In more adventuresome publications, demands for economic change have gone far beyond anything Mr. Gorbachev has publicly endorsed. In the June issue of a leading magazine, Novy Mir, the economist Nikolai Shmelyov proposes that the Soviet Union abolish subsidies and price-setting in favor of a free-market economy, that central planning be virtually eliminated, that the ruble be devalued to its real price in world money markets, and that leaders accept some unemployment as a natural byproduct of the economy.
>
> Mr. Shmelyov lays out a searing critique of contemporary Soviet Communism, and concludes that Mr. Gorbachev's plans are inadequate: "Just as we did in 1953 and 1965 we are again dooming ourselves to half-hearted measures. And half-heartedness, as we all know, is often worse than inactivity."
>
> Party officials and Western diplomats said it was not certain whether Mr. Gorbachev had enough support on the 307-member Central Committee to push through such revisions.
>
> Recent official polls have shown significant public misunderstanding and skepticism about economic changes, too. Although majorities profess support for Mr. Gorbachev and his agenda, many workers say they are afraid that moving away from a strictly controlled economy will mean more work with no quick rewards.
>
> The major economic change proposed in the new law, called "self-financing," would ultimately require each factory or state farm to be guided less by the central planners in Moscow and more by the profit motive.
>
> Rather than turning over its income to Moscow in exchange for a set budget, each enterprise would keep a share of its profits to spend as managers see fit. Thus, bonuses, benefits and modernization would depend more on the productivity of workers, who would have an incentive to work harder.
>
> The draft law also includes an important political component. It requires that all managers of factories and farms be elected by the workers from competing candidates. The idea is to shift power from central ministries in Moscow to local labor unions.
>
> Supporters of Mr. Gorbachev said the campaign for accelerated change arose out of a growing concern that economic recovery is moving too slowly and the draft law would not be enough to end its stagnation.
>
> "It became clear that if we pass this law, it may be several years before we can change it," said a Soviet lawyer who advocates more extensive reforms. "By then it may be too late."

A book has just been published titled "Gorbachev's Challenge, Economic Reform in the Age of Technology" written by Russian expert Marshall Goldman (Norton, $16.95). Goldman believes that Gorbachev comprehends the problem of cumbersome Russian central planning with its emphasis on heavy industry -- in a world moving rapidly and relentlessly toward high technology economics.

Goldman, whom the Russians listen to and read, recommends a "radical move towards decentralization and towards the market" plus "a reduction in the role for Russia's central planners." Goldman is not optimistic about this happening (it's obviously the last thing in the world the old Russian guard wants). And what if this does not occur? Goldman says that in that case Russia will, in a matter of years, cease to be a first rate power!

Conclusion: Communism in its present stultifying, centralized form is being pressed against the "economic wall." It simply can't produce or compete with the free world. Changes are coming in Russia, changes that will affect the entire world including the capitalist nations.

* *

ANNOUNCEMENT: I've never been fond of traveling, so these days I will only speak at a seminar if I like the sponsors, the speakers, and the city. One coming up in August qualifies for all three. I'll be speaking at the big ISI seminar being held August 26-30 at San Francisco's Fairmont Hotel. The seminar promises to be a winner with speakers such as Preston Martin, Bob Prechter, Paul Erdman, Al Frank, Mark Hulbert, Robert Stovall, Norm Fosback, Charles Allmon, Monty Guild, and many more. For info call 813 955 0323 or write ISI, 1859 Main St., Sarasota FL 33577.

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AIDS: Strangely, only one animal can contract the AIDS infection, and that's the chimpanzee. But just as strange, the chimp does not die of AIDS. Thus, scientists do not have the help of lab animals in attempting to find a cure for the disease.

Rand Corp., the California think tank, is estimating that the cost of AIDS for the US will reach $112 billion in 1991. Rand also concludes that states with big AIDS concentrations will see their Medicaid programs having to absorb between $10.2 billion and $47.3 billion in extra expenses.

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Debt: They keep thinking of new ways to build up debt in America. Home-equity loans, the latest gimmick, have risen to a total of $35 billion at present and are expected to double to $70 billion by the end of this year.

On another front, corporations fighting off takeover bids have devised a rather disgusting gimmick. The victim corporation borrows a huge amount of money, then presents its stockholders with a package of special dividends and stock. The process renders the intended takeover victim so laden with debt and so unattractive that the plunderer gives up on its plundering plans. Recently, Harcourt Brace Jovanovich tripled its current $837 million debt while promising to give its shareholders $40 a share plus a fraction of newly formed shares. Meanwhile, Allegis authorized a cash payment of $60 a share to stockholders from $3.5 billion in newly borrowed money.

Russell prognosis: When the next recession hits, these debt-choked companies could go belly up. If I held stock in one of these outfits, I would take the money and run.

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GOLD: Gold has been found in 34 of the 50 United States. The state of Nevada is now the No. 1 gold producer in the US with S. Dakota a distant second. With so many new gold mines in production here, the US has now passed Canada in gold production and is now the world's third largest producer (after S. Africa and Russia). In 1989 S. Africa is expected to produce 20.8 million ounces of gold, while the US should produce 5.7 million.

Meanwhile, the cost of gold exploration and production (thanks to new technology) has dropped from $350 per ounce in 1982 to roughly $250 today. Since companies can sell all the gold they can produce, this has made gold the best metal game in town. Over the next five years, world gold production is expected to rise 24%.

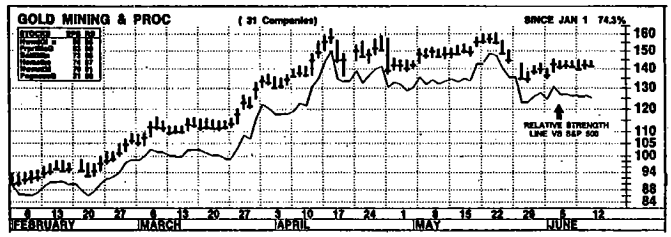
Question: Won't this drive the price of gold down?

Answer: The world is producing paper money faster than it is producing gold. If a recession or depression hits, the odds are that the world might try to print itself out of the woods via paper money. If that occurs, there could easily be a rush by people to swap depreciating paper for metal.

Each nation in the world counts its monetary reserves in terms of (1) its foreign currency holdings, and (2) its gold holdings. In other words, gold is the ONLY monetary reserve that cannot be printed. That makes it the ONLY asset the individual can hold that is a true monetary alternative to paper money. Platinum, diamonds, rare coins, stamps, etc. are all items of great value. But they are not money and are not really comparable to gold (which can be bought and sold in any quantity and which is quoted minute by minute around the world 24 hours a day).

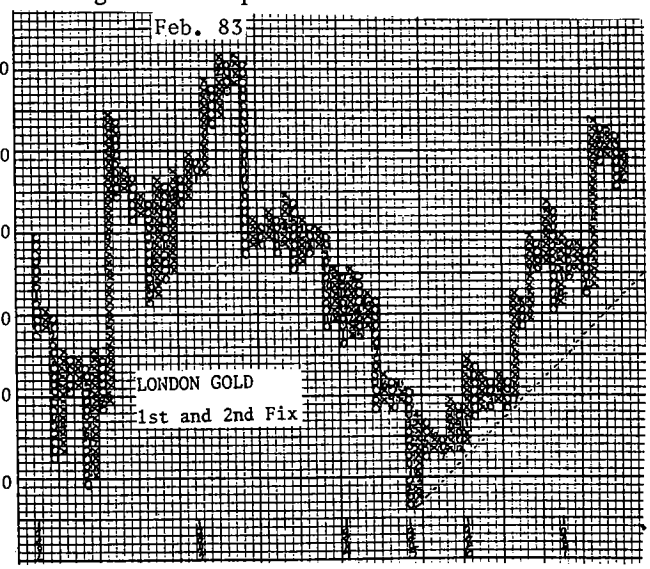
Since gold represents a part of almost every central bank's reserves, gold also boasts one unique property. Every central bank in the world wants gold to either *hold steady or move higher.* During a depression the pressure would be on to raise the price of gold, since that would boost a nation's monetary reserves during hard times.

This chart from Investor's Daily shows the path of the gold group (31 gold stocks) going back to February. Relative strength for the group hit its peak in mid-April and has been sliding since. But



actually, the gold stocks have not given up much on the downside despite waning relative strength.

Turning to the P & F chart of gold, the most important consideration here is that gold is holding ABOVE its long-term rising trendline. This trendline intersects at the 400 level. As long as this trendline holds, I would call gold bullish for the longer term. More recently, gold has filled in four X's (X's denote a rally on the chart), and this is a positive sign. However, a major bullish breakout for gold would require a London fix of 480.



NEXT MAILING: July 1

I continue to advise monthly accumulations of the bullion gold coins, and this includes Krugerrands, Coronas, Maple Leafs, Eagles. The easy way to enter the precious metal stock picture is via Lexington Goldfund (800-526-0056 or in NJ 800-932-0838). A second choice is Financial Strategic Gold Portfolio (800-525-9831 or in Colo. 800-525-9769). Both are no-load mutual funds.

LATE NOTES: Question: Russell, why do you even bother to write a full report? Why do all the work? Why not just publish your PTI statistics every week or so and leave it at that?

Answer: Sometimes I think I'd be better off if I did exactly that. The PTI (my own invention) has always been smarter than I am. Anyway, the way I've been doing it subscribers get the valuable PTI statistics plus the Russell rantings (which have to be worth something). But I'll say it again -- the rules here are (1) never to doubt the PTI, and (2) always stay on the right side of the PTI.

So what's happening with the PTI? As of the close, June 12, the PTI sat at a new bull market high of 2626, 2 points above its previous high set on April 6 (see page 2 chart). Any way you look at it, you've got to be impressed by this action. Over the past two months the PTI had ample opportunity to break down. On April 27 the PTI came within 4 points of its 89-day moving average. It rallied. Again on May 20 the PTI came within 6 points of its MA. Again it rallied. Older subscribers know that there will be no market collapse while the PTI is in a rising trend (which it is). Furthermore, if the PTI continues on its upward path, it will literally force all the averages and indices to new highs.

Meanwhile, as further background my feeling is that the dollar has bottomed out, at least for a while. Despite new highs in the Japanese stock market, the Japanese yen is turning weak, as is their economy. Things are happening fast here in 1987. Keep tuned.